

**BUDGETARY PRACTICES
OF HUNGARIAN LOCAL
GOVERNMENTS**

THE NEED FOR CHANGE

Prepared for



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Eastern European Regional Housing Project
Project 180-0034
U.S. Agency for International Development, ENI/EEUD/UDH
Contract No. EUR-0034-00-C-2033-00, RFS No. 52



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July 1996
UI Project 06251-052

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With the transfer of government responsibilities to municipalities, Hungarian cities and towns have considerable autonomy to make a variety of decisions impacting the lives of the citizens who reside within their borders. In the area of financial management, cities must allocate limited financial resources to finance a diverse array of activities. Funding decisions regarding municipal services, activities, infrastructure investment, etc., now rest with the mayor and local council. This allocation must be in accordance with requirements established by the central government.

Unfortunately, Hungarian cities were not given the technical skills or training to effectuate this transition smoothly and efficiently. Cities were making allocation decisions with limited information. Moreover, little attempt was made to evaluate the impact these investment decisions had on the quality, effectiveness and efficiency of the services provided, or on the overall community and its citizens.

It is often said that the art of budgeting in government is essentially a process of allocation of limited financial resources to services and activities in a manner that will most effectively meet the needs of the populace to be served. The City of Szolnok offers an example of how USAID supported technical assistance brought about positive change in the City's budgetary practices and procedures to better serve the needs of the populace. At a seminar held in July 1995, five other cities indicated their strong interest in undertaking similar projects. USAID will now build on the Szolnok budget experience (and use it as a case study), by expanding the program to other Hungarian cities.

TRADITIONAL BUDGETING PRACTICES: THE NEED FOR CHANGE

Local government budgets in Hungary traditionally comprise of a general policy statement and line item detail, which conforms to central government accounting classifications. The same was true for Szolnok. In fact, prior to its budget reform, Szolnok's budget was typical of a Hungarian local government budget. The budget emphasis was on line item detail such as wages and commodities. There was little in the budget document or interim financial reports that would enhance one's understanding of the programs, activities or services provided by the City. In addition, the budget did not distinguish between capital and operating expenditures. This lack of clarity was further exacerbated by the presentation of individual institutional budgets at a high level of abstraction. For example, the budget for the Office of the Mayor was a laundry list of expenditures for all City offices. This made it difficult, if not impossible, to understand how the city truly allocated its resources.

Budget analysis was limited to taking the prior year's expenditures for personnel and adding an inflation factor based on central government requirements. Once central government grants were determined, these amounts were added to the budget. Individual institutions submitted a summary budget to Finance for review. There was no program detail and no standard criteria to guide the submission or evaluation of these requests. These requests were forwarded to the general meeting Budget Committee, and the committee that has functional responsibility,

for review and approval or rejection. Given the limited financial resources, requests for new activities were rarely funded.

Once the general meeting approved the budget, institutions submitted detailed line item budgets. These budgets were not subject to scrutiny. They were merely a breakdown of how monies already allocated would be expended. In essence, the City did not know what it was buying until it was too late. Finance played a coordinative role throughout the budget process. Decision making rested with the general meeting and its various committees. There was no multi year forecasting, budget monitoring or analysis, cost analysis, etc.

SZOLNOK'S INITIATIVE

Szolnok's finance staff was uncomfortable with the budget process. There was a recognition that the status quo budget process obscured what was truly happening in the City. Were the best budget investments being made? Were program managers challenged to think about the most efficient and effective ways to deliver services? What services were being provided? At what cost? What were the results? Knowing the answers to these and many other questions moved City officials to rethink the Szolnok budget process and format. Working with a consultant provided by USAID, Szolnok transformed its budget within two years (1994—1995) from one concerned with the purchase of goods and services to one that focuses on programs, activities, investments and accomplishments.

Program budgeting allows for improved decision making by linking revenues and expenditures to those programs that meet the City's goals, objectives and strategies. Furthermore, the anticipated results and outputs of these investments are identified.

City officials believed this type of budgeting would serve four important needs.

- *The budget would serve as a policy setting mechanism.* City policy makers would have a process within which to identify Szolnok's financial and operational policies that will guide budgetary decisions. The budget document would identify: (1) financial and program policies, goals and objectives; (2) policy issues; and (3) City priorities.
- *The Budget Would Serve as a Financial Plan.* The budget would serve as the City's financial plan by identifying revenues and expenditures. Through the use of charts and tables, the City would present financial data in a clear, concise and easy to comprehend manner.
- *The Budget Would Serve as an Operations Guide.* The budget of each institution not only identifies the cost of each activity, but also the level of service to be provided, the number of citizens who will benefit from the service, and the staffing level required to carry out the activity. These data will be used in future years to make year to year comparisons. By making these comparisons, the City will be able to assess program efficiency and effectiveness, and take appropriate corrective action.
- *The Budget Document Would Serve as a Communication Device.* The budget document is the mechanism by which citizens, municipal officials, policy makers, potential investors and others can understand Szolnok budgetary issues, trends, and



choices addressed in the budget. The document is intended to communicate the significant information in the budget to the reader.

Szolnok's "New" Budget

The results of Szolnok's efforts have been most gratifying to all those involved. After completing its test budget with housing and City operations, the budget was expanded to include most city institutions and all city departments. Szolnok developed a budgeting process which, among other things, articulates municipal services in the language the community and policy makers can understand, while making better investment decisions. The City implemented a program budget, or perhaps it should be called a Smart Investment Budget. The budget developed consists of several crucial components: (1) a program structure; (2) statistical analyses of city revenue and expenditure trends as well as demographic trends; (3) condition statements; (4) program policies; (5) anticipated outputs and results, and (6) enhanced management systems.

The program structure is the cornerstone of Szolnok's budget. Programs, not commodities, are identified. It is the point at which resources are both forecasted and allocated and measurable objectives established for program evaluation. To establish priorities, the Finance Department concerned itself not only with identifying "what is" but also gathering information needed to make judgments concerning the critical nature of "what ought to be." Statistical data helped immensely. For Szolnok, this was no easy task. The City had to develop the statistical indices it needed, obtain the data, organize it in a way that would be useful, and analyze it to identify existing conditions and trends. Importantly, Finance worked closely with its data processing staff to computerize all these data.

The City now has a data base that was used for budget analysis. The real benefit for the City, however, will be in future years. Year-to-year comparisons can be made. As conditions change, the City can more readily change allocations to meet these changes. Importantly, the City now has a means of measuring the perceived and actual effectiveness and efficiency of City services.

By coupling financial analysis with program analysis under a common structure, the City is now able to view the purpose for which an activity is performed and how it relates to other similar activities rather than focusing on a maze of isolated funds and separate organizational units. In this way, requests for new services, service expansion, or consolidation can be deliberated with an understanding of the long term resources available for program support. This not only permits fiscally responsible decision making but also enables program trade-offs as priorities change or forecasts are modified. For example, Szolnok used financial data and program data to justify the decision to consolidate schools. Without these data, and the careful analysis, it is doubtful this consolidation would have taken place.

The final component of Szolnok's budget reform is the development of management systems to ensure policy decisions are implemented. City departments and institutions have been asked to establish measurable objectives for each service provided. Finance staff has taken the



lead in assisting in refining program objectives and performance objectives formulated by departments and institutions. Staffs in the offices responsible for preparing program budgets positively received the challenge. It afforded an opportunity to describe the need for these programs, highlighted anticipated program accomplishments, and defined the resources required to obtain these accomplishments.

The responsibility for monitoring performance resides with Finance through quarterly reporting and review. While the program budget has recently been adopted, the City views this quarterly review as an opportunity to evaluate and measure its success or failure in meeting expressed program objectives.

From the policy making perspective, elected officials now have a basis to make more informed decisions. The mayor's general meeting can now discuss policy issues, analyze services and service levels and review the data that support the recommendations made. With rising costs, continued high inflation and fixed or declining resources, such approaches must be adopted if Hungarian cities are to survive as viable forms of local government in the future.

MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS

USAID will now introduce better municipal budgeting across Hungary via an interactive program between Hungarian local governments and Hungarian and international resource experts from 1996—1998. In the first year of the program Hungarian experts will build on six core resource packets provided by the contractor, and through a flexible training program with local governments, revise, modify and adapt the resource packets to one best suited for Hungarian municipal needs. This process will be achieved via:

- A refinement of the existing program in Szolnok for use as a case study.
- Survey of the budgetary reform needs of other cities.
- Identification of resource experts and development of resource packets on six topics.
- Financial tools and budgetary processes tested and refined by local governments.

By end 1996, the program would have developed a cadre of Hungarian experts and a group of 15-25 local governments who have adapted and refined budget training materials to one which is purely Hungarian. In 1997 and 1998 the program will be expanded to include more local governments as well as increase the network of Hungarian municipal experts.

Survey Response

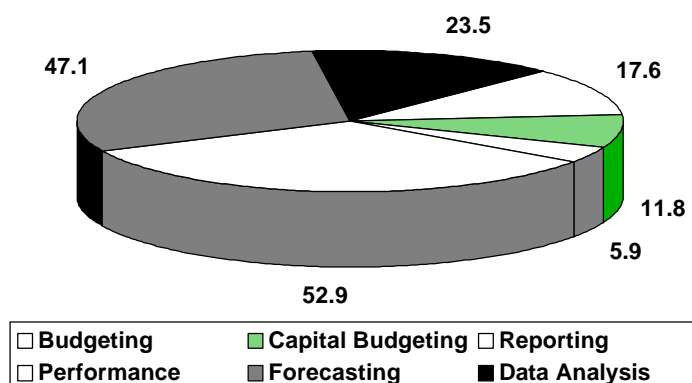
The structure of the new program (which will be initiated in June 1996) is being based on several interviews with local government experts—at the Ministry of Interior, municipality of Budapest, banks, and local government finance officers—and a survey of financial practices and

needs of Hungarian local governments. The objective is to visualize a program which will be responsive to the needs and objectives of local governments in their budgeting process.

A questionnaire was mailed in March 1996 to approximately 60 municipalities, of which 17 responded. The results of the survey highlighted: (1) the areas prioritized for technical assistance by finance officers; (2) financial management practices rated “most important;” (3) budget practices not used by local governments, and (4) current disparity between budgetary practices and objectives.

Effective financial management practices involve elements and combinations of each of the following: budgeting, capital programming, financial reporting, performance measurements, forecasting and data analysis. Of these, budgeting itself integrates elements of the other five topics. As seen in figure 1, performance measurement, forecasting and data collection were the top three priority areas—52.9 percent, 47.1 percent, and 23.5 percent respectively—in which finance officers expressed an interest.

Figure 1
Areas Prioritized for Technical Assistance



The table below shows the top six financial management practices which were rated most important by finance officers on a scale from “least important” to “most important.” Seventy seven percent of respondents rated analyzing the impact of capital expenditures on operating and maintenance costs as “most important,” and 65 percent ranked the development of a detailed list of financing options for each capital expenditure at the highest level. Other important priorities were issues related to forecasting, followed by the establishment of policy guidelines at the outset of the budgetary process.

Table 1
Financial Management Practices Rated “Most Important” by Municipalities



Financial Management Practices	Percent
Analyze impact of capital expenditures on operation/maintenance costs	76.5
Develop financing options for each capital expenditure	64.7
Forecast revenues	64.7
Forecast expenditures	64.7
Establish policy guidelines at the outset of the budget process	58.8
Use computers for analyzing data	58.8

The survey also gave interesting results on financial management practices currently not being used by respondents. Forty seven percent responded that “we cannot forecast anticipated revenues for the next fiscal year with 5 to 10 percent accuracy.” The same percent responded that “we do not make multi-year forecasts.” About one-third of the respondents stated that they do not: (1) collect budgetary data for financial/policy decisions, (2) evaluate both expenditures and services of municipal departments, and (3) analyze the impact of capital expenditures on operational and maintenance costs.

Finally, the survey highlighted two areas where there exists a significant disparity between municipal budgetary practices and objectives. Even though approximately 78 percent responded that analyzing the impact of proposed capital expenditures on operating and maintenance costs is “most important,” only 58 percent of respondents are currently practicing this. Similarly, about 67 percent stated that forecasting anticipated revenues for the next fiscal year is “most important,” but currently only 48 percent are actually doing this.

The results of the survey has helped shape the form and content of the training material in the *Modernizing Financial Management for Hungarian Local Governments* program. It has also stimulated respondents to begin thinking critically about the current budgeting procedures and their role and function as municipal finance officers.

Identification of Hungarian Experts and Trainers

One of the objectives of the *Modernizing Financial Management for Hungarian Local Governments* program is to develop a cadre of Hungarian experts—Hungarian finance officers and other individuals—who are well versed and trained in sound financial management practices. These individuals will be crucial to maintain, sustain and expand best practices in program budgeting in the country.

In addition to the contractor, and local Hungarian sub-contractor, four Hungarian local trainers have been identified for the pilot year of the program: Mr. József Kéri, Dr. Mihály Lados, Ms. Katalin Pallai, and Dr. András Vigvári. Mr. Kéri is currently Head of the Economic Department for the City of Szolnok, and the motivating and principal individual involved in reforming the Szolnok budget. Mr. Kéri is the most appropriate person to give feedback on expanding the Szolnok experience to other Hungarian local governments. His insights on feasible and practical matters related to reforming the budget will be extremely crucial in defining materials and training sessions under the new program.

Dr. Lados has a Ph.D. in Economics and is a senior research fellow at the Hungarian Academy of Sciences. He has been teaching municipal finance at the Academy and has also served as a trainer and provided technical assistance in the past. Ms. Pallai is a special counselor to the Municipality of Budapest. She has practical experience on city policy and budgets since 1991. Dr. Vigvári is the general manager of the business analysis and development department of Budapest Bank. He has a Ph.D. in economics and has both practical and theoretical knowledge, based on his current profession and past extensive teaching experience. Dr. Vigvári has published and written extensively on local governments in Hungary.



All of the above trainers will play an important role in modifying and reviewing core training materials from the contractor and adapting it to the Hungarian context, preparing case studies and other training material, conducting seminar sessions, and serving as a general resource. As the program expands in the second and third year, a larger number of trainers will be recruited.

CONCLUSIONS

An effective municipal budget can serve several purposes. It can be:

- An operations guide that provides guidance to department and institution managers and measures their productivity;
- A financial plan that provides a comprehensive multi-year perspective of the City's financial condition; and
- A powerful communication tool that brings valuable information to the citizens, business persons, those considering making investments in the community, central government officials and others.

The Szolnok budget process is still in transition. The process is moving forward rapidly, exceeding all expectations. The Szolnok budget document is the single policy document that articulates the City's fiscal and program policies and explains the rationale for these policies.

From a USAID investment perspective, multiple benefits have been derived from this effort. Hungarian cities can bring about budgetary reform. Cities can effectively and efficiently allocate limited resources. There is now a model other Hungarian cities can use to reform their own budgets in a cost effective way. Hungarian municipal and ministry officials, who have had the opportunity to examine the Szolnok budget, have given it rave reviews. It is a very effective, well crafted document. Szolnok municipal officers are passionate and effective spokespersons for budget reform. They will be powerful communicators for budget change among their municipal colleagues.